51. In August 1994, the CPUC ordered the unbundling of access charges from cellular wholesale rates, giving resellers the option of maintaining their own switches and obtaining interconnection directly from the local exchange carrier.[111] The CPUC Order also gave resellers a block of telephone numbers directly from the number administrator.[112] The pleadings raise the question whether Section 332(c)(3)(B) barred the CPUC from enacting these particular regulatory provisions, or any others, after June 1, 1993.

2. Pleadings of the Parties

52. Several opponents of the CPUC Petition, including AirTouch, CCAC, L.A. Cellular, McCaw, and US West, point out that none of the regulations in the August 3, 1994 Order of the CPUC was in effect on June 1, 1993, or was a part of the California regulatory framework as of that date.[113] They argue that the August 3, 1994 CPUC Order is an attempt to "grandfather" these regulations along with those CPUC regulations that were in effect as of June 1, 1993, for the duration of the state petition proceeding. In support, they focus on the phrase "existing regulation" in the second sentence of Section 332(c)(3)(B), arguing that the grandfathering provision is regulation-specific and that it refers only to "any [specific] regulation" that was "in effect on June 1, 1993."[114] The various opponents contend that, as a result, the adoption of new regulations by the CPUC after June 1, 1993, was contrary to the Congressional mandate of Section 332(c)(3)(B)[115] and was preempted by the statute.[116] Similarly, one commenter also contends that the CPUC is barred from issuing any rules as a result of its two investigative proceedings commenced after June 1, 1993, unless and until its Petition is granted.[117]

53. In its Reply, the CPUC asserts that it is a state's authority to continue to regulate CMRS rates that is preserved from preemption during the pendency of its petition,

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[111] CPUC Interim Opinion, Aug. 3, 1994 (August 3, 1994 CPUC Order).

[112] *Id.*

[113] *See* Comments of AirTouch at 18; CCAC at 93-100; L.A. Cellular Reply at 53-54 (pointing out that rate-based regulation and reseller switching requirements were not in effect as of June 1, 1993). *See also* Comments of McCaw at 26-28 & n.64; US West at 17-18.

[114] *See, e.g.,* McCaw Comments at 27 & n.64.

[115] *See, e.g.,* Comments of AirTouch at ii-iii; McCaw Comments at 24-28.

[116] *See, e.g.,* US West Comments at 18.

[117] *See* Comments of US West at 18 & n.13 (referring to CPUC investigations, *e.g.*, I.93-12-007, initiated in December 1993, seeking to modify the existing California regulatory framework based on whether a carrier is dominant or non-dominant).

not the precise set of regulations in place as of June 1, 1993.[118] In support, the CPUC focuses on repeated references to a state's "authority over rates" in Sections 332(c)(3)(A) and 332(c)(3)(B) and explanations in the underlying legislative history concerning Congress's intention to adopt "a 'grandfathering' provision that permits states that regulate the rates for any commercial mobile services as of June 1, 1993 to continue to exercise such authority until the Commission issues a final order in response to a petition...."[119] The CPUC emphasizes that Section 332(c)(3)(A) is articulated solely in terms of "authority," that Section 332(c)(3)(B) reiterates the provision in subparagraph (A) that any grant of a petition by this Commission "shall authorize the State to exercise under State law such authority over rates, for such period of time, as the Commission deems necessary to ensure that such rates are just and reasonable and not unjustly and unreasonably discriminatory," and that Section 332(c)(3)(B) expressly references Section 332(c)(3)(A) and should be read in the context of that subparagraph. The CPUC concludes that, when the phrase in Section 332(c)(3)(B) referring to "existing regulation" is read in the entire context of Section 332(c)(3), it is apparent that Congress intended to "grandfather" a state's authority to regulate rates, rather than those specific regulations in place as of June 1, 1993, and that use of the term "regulation" in Section 332(c)(3)(B) was "simply a shorthand reference to regulatory authority."[120]

54. California also invokes the Congressional policy underlying Section 332(c)(3) as an aid to statutory interpretation and asserts that Section 332(c)(3) and the underlying legislative history demonstrate that Congress viewed the role of the states as significant in furthering the transition to competition within intrastate markets for CMRS services. It argues that, given this policy and the rapid and dynamic technological changes beginning to emerge in the wireless industry, it makes no sense to believe that Congress intended to lock a state in to a particular set of regulations that could be as many as two years old and might no longer serve the public interest, rather than giving it the flexibility during this transition to adapt its regulations to continuing technological and market changes.[121]

3. Discussion

55. We do not believe that the language of Section 332(c)(3) lends itself to the interpretation advocated by the cellular carriers, particularly in light of the statutory objectives underlying that Section. The phrase "such authority over rates" is clearly generic, rather than regulation-specific. Section 332(c)(3)(A) preempts states from regulating CMRS

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[118] CPUC Reply at 87-95. *See also* Cellular Resellers Reply at 45-50.

[119] CPUC Reply at 90-93, *citing* Conference Report at 493.

[120] *Id.* at 92 n.127.

[121] *Id.* at 93-94.

rates by providing that "no state ... shall have any authority to regulate ... the rates charged by any commercial mobile service ...."[122] The exception to this preemption, set forth in both subparagraphs (A) and (B), is also articulated in jurisdictional terms: "If the Commission grants such petition, the Commission shall authorize the State to exercise under State law such authority over rates ... as the Commission deems necessary ...."[123]

56. Subparagraph (B) also addresses the question of interim regulation for petitioning states that had "in effect, on June 1, 1993, any regulation concerning ... rates" and provides, with respect to such states, that "the State's existing regulation shall, notwithstanding subparagraph (A), remain in effect until the Commission completes all action ... on such petition."[124] We conclude that the use of the term "regulation" in these provisions of subparagraph (B), rather than the phrase "authority to regulate rates," is without significance because subparagraph (B) is framed as an exception to a jurisdictional rather than a regulation-specific preemption. Thus, we agree with the CPUC that use of the term "regulation" in subparagraph (B) is merely a "shorthand" or alternative reference to a state's rate regulation authority.

57. Our conclusion is supported by the legislative history of the grandfathering provision. The Conference Report notes that the Senate Amendment "grandfathering provision" was added in part in order to provide "regulatory certainty to potential bidders for licenses to provide commercial mobile services."[125] What is meant by the concept "regulatory certainty" in this context is explained in the next sentence: "The Conference Agreement clarifies that State authority to regulate is 'grandfathered' *only to the extent that it regulates commercial mobile services 'offered in such State on such date.'*"[126] The inference from the emphasized language is clear: if the rates for a certain class of CMRS, such as paging, are not regulated as of June 1, 1993, a state cannot assert such jurisdiction after that date or during the pendency of its petition. What is grandfathered is the state's assertion of jurisdiction, not the particular regulations promulgated as an exercise of this jurisdiction. This conclusion is buttressed by the Conference Report's exclusive use of the phrase "authority to regulate" in explaining the provisions of subparagraph (B), in general, and the grandfathering provision in particular. The latter is further elucidated by the following statement in the Conference Report: "State authority to regulate is only 'grandfathered' if the state files a petition seeking such authority ...; if the state fails to file [such] a petition ... the

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[122] 47 U.S.C. § 332(c)(3)(A).

[123] *Id.*

[124] 47 U.S.C. § 332(c)(3)(B).

[125] Conference Report at 493.

[126] *Id.* (emphasis supplied).

state authority is preempted under subsection (c)(3)(A).''[127] That which is preempted is jurisdictional in nature; likewise, that which is grandfathered also is jurisdictional in nature.

58. Finally, and of equal importance, we base our interpretation concerning the scope of the grandfathering provision on the policies underlying Section 332(c)(3). We agree with the CPUC that, given the Congressional objectives of relieving presumptively unnecessary intrastate rate regulation of CMRS and promoting the operation of market forces to effect just and reasonable rates, Congress could not have intended to calcify regulations adopted by California as many as two years prior to final action by this Commission on the CPUC's petition to continue such rate regulation. Such a denial of flexibility would be particularly imprudent given the rapid technological innovation characteristic of the present CMRS market and anticipated changes in market structure and performance resulting from the advent of PCS and wide area Specialized Mobile Radio (SMR) services. At its extreme, such an interpretation would prohibit a state from alleviating regulatory burdens that events subsequent to their enactment had rendered unnecessary. Such Congressional deference to outmoded regulation is nowhere evident in the statute.

59. On the foregoing bases, we conclude that, pursuant to Section 332(c)(3)(B), the regulations promulgated under state authority after June 1, 1993, remain in effect, if the state has preserved that authority by filing a petition to continue to exercise authority over CMRS rates. This would include regulations adopted by the CPUC during the pendency of its Petition, pursuant to investigations initiated after June 1, 1993.

D. Elements of the CPUC Case[128]

1. Market Structure

60. The CPUC argues that the FCC-created duopoly market structure for cellular services has created ''near absolute'' barriers to entry and a consequent lack of potential competitors' access to ''bottleneck facilities,''[129] citing, in support, DOJ's Memorandum in Response to the Bell Companies' Motions for Generic Wireless Waivers, concluding that ''cellular duopolists plainly have market power in cellular service'' and that

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[127] *Id.* at 493-94.

[128] Our discussion of the pleadings uses as an organizational methodology the components of the Structure-Conduct-Performance paradigm, with the result that issues that arguably could be categorized under more than one heading have necessarily been assigned to that which best facilitates our discussion as a whole.

[129] The CPUC defines ''bottleneck facilities'' in this context as the cellular radio spectrum and switching facilities. *See* CPUC Petition at 25-27; *see also* Comments of CATA at 7-8.

''cellular exchange service markets are not competitive today.''[130] California argues that this market structure, together with interlocking ownership interests within and among California cellular markets,[131] have inhibited the emergence of competition in California's cellular industry.[132] Adopting the *Merger Guidelines* in order to facilitate its analysis of this duopolist market,[133] the CPUC defines the relevant market in terms of the substitutability of other mobile communications services[134] and identifies cellular service as the relevant market because it concludes that no viable alternatives to cellular service presently exist.[135] California points out that meaningful deployment of wide area SMR by Nextel will not occur until 1995 or later[136] and that PCS, which also is a likely substitute for cellular service, will have to develop a geographically dispersed and operational network before being able to offer service at competitive prices.[137] The CPUC estimates that, until these comparable services can provide adequate competition, the only viable source of competition will continue to be the cellular resellers.[138]

61. The CPUC has offered various data and accompanying analyses in support of its contention that the cellular carriers have market power and that the California cellular market is insufficiently competitive, in consequence. It argues that the market share between the duopolist cellular carriers in the same markets has remained substantially the same over a five-year period and that it has steadily increased at the expense of the cellular resellers.[139]

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[130] *See* CPUC Petition at 27, citing Memorandum in Response to the Bell Companies' Motions for Generic Wireless Waivers with the United States District Court for the District of Columbia Circuit, Civil Action No. 82-0192, filed July 25, 1994, at 13-14; *see also* Comments of Cellular Resellers at 2-3.

[131] California points out that a total of 16 MSAs, including the major markets of Los Angeles and San Francisco, and four RSAs are affected by interlocking directorates and emphasizes that we voiced concern about this situation in the *CMRS Second Report and Order*, 9 FCC Rcd at 1468. CPUC Petition at 27-28 & Appendix C.

[132] CPUC Petition at 68-70.

[133] *Id.* at 21-23; CPUC Supplemental Reply at 10. For arguments critical of using the *Merger Guidelines* in this context, see McCaw Comments at 36.

[134] CPUC Petition at 23-25.

[135] *Id.* at 21-25, 65-70.

[136] *Id.* at 65; CPUC Reply at 15-17.

[137] CPUC Petition at 75-78; CPUC Supplemental Reply at 2.

[138] CPUC Supplemental Reply at 11-14.

[139] CPUC Petition at 29-34.

California also has employed the Herfindahl-Hirschman Index (HHI) to calculate a market concentration of 3750 for the California cellular industry, argues that this result provides evidence that the cellular market is highly concentrated "even if Nextel were a viable competitor today," and contends that this high degree of market concentration is further evidence of market power by the duopolist cellular carriers.[140]

62. The cellular carriers take issue with several points in the CPUC's structural analysis of the cellular market in California. They argue that mere proof that the cellular industry is a duopoly is insufficient to sustain the state's burden of proving that market conditions are inadequate to protect subscribers, since Congress was well aware of the duopolist structure of the cellular market when it nevertheless preempted states from rate as well as entry regulation of CMRS.[141] They also contend that the cellular carriers do not exercise bottleneck control.[142] Several assert that relative wholesale market shares between duopolist carriers in a particular geographic market did change during the period in question.[143] However, they also maintain that market share is not necessarily reflective of insufficient competition and may, in some instances, be attributable to differences in the size of the carriers' respective coverage areas.[144] With respect to resellers and market share, they assert that the resellers' decline is attributable to a proportionately lesser increase in customers than that for cellular carriers,[145] that the CPUC's data ignore the market share of retail chains,[146] that there is no proven correlation between reseller market share and

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[140] *Id.* at 31-34. *See also* CPUC Supplemental Reply at 15-17. The Herfindahl-Hirschman Index (HHI) is determined by summing the squares of the market share of each competitor in the market. The higher the H value, the less competitive the industry. An industry is highly concentrated if its HHI exceeds 1800.

[141] *See, e.g.*, Supplemental Comments of AirTouch at 4. GTE argues that the state must establish the existence of collusive behavior in order to prevail. GTE Supplemental Comments at 12-13. The CPUC contends that the statute does not require an antitrust analysis. CPUC Supplemental Reply at 7, 22-23.

[142] *See, e.g.*, Comments of AirTouch at 30-31; Affidavit of B. Owen for McCaw at 3, citing finding to this effect in *CMRS Second Report and Order*. *Contra*, NCRA Comments at 1-2.

[143] *See, e.g.*, Supplemental Comments of McCaw at 4; GTE at 8.

[144] GTE Supplemental Comments at 7-8.

[145] McCaw Supplemental Comments at 6.

[146] Supplemental Comments of AirTouch at 12. Hausman contends that large retail chains are the most efficient distribution method for cellular equipment and service.

competition,[147] and that OBRA protects customers, not competitor inefficiencies.[148] McCaw suggests that any future unfair practices against resellers by cellular carriers can be remedied through this Commission's complaint authority and contends, further, that this Commission has acquired jurisdiction over intrastate CMRS rates, in the absence of a successful state petition.[149] Several cellular carriers challenge the CPUC's market concentration data and analysis, arguing that the CPUC has erroneously treated both carriers in a market as a single entity when calculating the HHI,[150] that California's is the least concentrated cellular market in the Nation and that the effect of competitors' relatively small market shares nevertheless may be significant because prices are determined by reference to those customers initiating service; *i.e.*, competition in the cellular industry ''takes place at the margin.''[151]

2. Conduct

63. The CPUC contends that the activities of cellular carriers in California have exacerbated the inherently noncompetitive nature of cellular's duopoly market structure. It asserts that several practices employed by the cellular carriers have anticompetitive effects, including the use of ''lock-down'' contracts to obligate customers for longer commitments[152] and parallel pricing, which the CPUC alleges is facilitated by the existence of interlocking ownership interests within and among the various geographic markets.[153] The CPUC also contends that confidential data obtained by the California Attorney General as part of a study of the cellular industry buttress the CPUC's arguments on the issue of anticompetitive behavior by cellular carriers.[154] Cellular Agents Trade Association (CATA) contends that the cellular carriers have shifted distribution modes from independent agents to multi-outlet mass

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147 Supplemental Comments of AirTouch at 12; McCaw at 5; Supplemental Reply of AirTouch at 8; McCaw at 5.

148 Supplemental Reply of AirTouch at 10.

149 McCaw Comments at 6-7 & Supplemental Reply at 5-6.

150 *See, e.g.*, Comments of CCAC at 17-28.

151 *See, e.g.*, Supplemental Comments of AirTouch at 10-11; McCaw at 7. In his affidavit filed with AirTouch's Comments, Hausman cites the example of the airline industry in support of his contention that market share data are largely irrelevant where the market is characterized by new entrants. Hausman at 23-24.

152 CPUC Petition at 45.

153 *Id.* at 40-45; CPUC Reply at 72.

154 CPUC Petition at 74; CPUC Supplemental Reply at 33-37. These confidential data have been considered in rendering a determination in this proceeding but are nowhere discussed with specificity in this Order.

merchandisers such as Circuit City and Sears, that preferential treatment accorded the latter has driven many independent agents out of business, and that this constitutes a strategy by the cellular carriers to monopolize the market for cellular equipment.[155]

a. "Lock-Down" Contracts

64. The record compiled by the CPUC demonstrates that the CPUC has acted to constrain carriers' marketing practices affecting cellular service contracts, in particular the "automatic renewal" provision. The CPUC indicates that it will permit renewable contract services to remain, provided that the contract term is limited to three years, that any termination penalties are prorated, and that in no case do termination penalties apply after the first year. In addition the CPUC requires customer signatures on contracts with penalties, and customer notice prior to contract renewal.[156]

b. Parallel Pricing

65. The CPUC contends that a review of the prices charged by cellular carriers in the major California markets reveals a pattern of parallel pricing which, when combined with other factors, is consistent with a noncompetitive market.[157] It contends that tariffs for the two facilities-based carriers in the Los Angeles market show nearly identical discount plans which were filed within two days of each other, as well as discount plans with identical features. The CPUC rejects the carriers' argument that this synchronicity of pricing is attributable to the anticompetitive effects of tariffing and resultant notice of competitors' price changes and ascribes the phenomenon, instead, to the fact that the "two carriers are tacitly aware of each other's pricing strategies."[158]

66. Several commenters observe that a more competitive market structure than the cellular duopoly might manifest "parallel pricing" between different firms because production, marketing, and consumer preference considerations are accurately and consistently perceived by multiple firms. They also contend that pricing similarities are facilitated by regulation because tariffing requirements provide advanced notice of impending price changes by competitors. CCAC disagrees that discount plans are similar in the Los Angeles market.[159]

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[155] CATA Comments at 5-7.

[156] *See* CPUC Petition at 18-19.

[157] CPUC Reply at 72.

[158] *Id.*

[159] CCAC Comments at 20, Appendix B.

3. Indicia of Performance

67. The CPUC contends that the duopolist market power of the cellular carriers in California is reflected in their rates of return and the prices charged for cellular service, which it alleges have been maintained at an artificially high level by the carriers' deliberate underutilization of cell sites. It also points to other indicia of performance such as the lesser prices paid for PCS, as opposed to cellular, spectrum, and the Q Ratios derived from the market values for cellular firms.

a. Q Ratios and Spectrum Value

68. A firm's Q Ratio is the ratio between its market price and the replacement cost of its assets. California states that a recent study of 20 U.S. industries shows a Q ratio of 3.32 in the 1961-1985 period. It alleges that, in contrast, cellular firm Q ratios ranged from 6.68 for small firms to 13.52 for large firms, nationwide,[160] and that the Q ratios for cellular firms in Los Angeles and San Francisco were among the highest in the Nation.[161] The CPUC argues that this disparity between market price and asset value is attributable to the supracompetitive rates charged by cellular carriers with market power sufficient to control prices in the California market. The CPUC derives additional support for this argument from the market prices for cellular, as opposed to PCS, spectrum. It contends that the present per ''POP''[162] value for PCS spectrum, including major urban areas, is $14, whereas that for cellular spectrum is $200 per POP. It ascribes this disparity in values to cellular carriers' ability to extract duopoly rents.[163]

69. The Cellular Resellers are in accord with the CPUC's Q ratio analysis.[164] However, several cellular carriers challenge the relevance of Q ratios to market power and

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[160] The Q Ratio analysis was developed by Thomas W. Hazlett. *See* T. Hazlett, Market Power in the Cellular Telephone Duopoly, A Report Prepared for Time Warner Telecommunications, August 1993. According to the analysis, market price is based on the discounted stream of expected profits, and an excessive market price when compared to asset replacement cost reflects investor expectations of profits above the competitive level. In a subsequent paper, Hazlett recalculated the Q Ratio for cellular carriers as 5.9, based upon adjustments advocated by critics of his earlier estimates. *See* Hazlett, ''Errors in the Haring & Jackson Analysis of Cellular Rates,'' attached to CPUC Reply as Appendix M.

[161] Petition at 62-63; CPUC Supplemental Reply at 18.

[162] The term ''POP'' is a term of art referencing each person of the resident population in a given service area.

[163] *See, e.g.,* CPUC Supplemental Reply at 23.

[164] Comments of Cellular Resellers at 26.

claim that a high Q ratio is as consistent with spectrum scarcity as with extraction of monopoly rents.[165] Others allege that factors such as growth exaggerate a firm's Q ratio.[166] With respect to spectrum value, several carriers contend that high prices, both for cellular licenses and cellular service, reflect the scarcity of spectrum, rather than a noncompetitive market with only two carriers.[167]

b. Cellular Service Rates

70. California contends that, although rates have been somewhat suppressed by state regulation, cellular rates for the major California cellular carriers remain among the highest in the Nation.[168] It states that its review of basic and discounted rate plans disclosed "[s]tagnant or slowly declining cellular rates" in a context of lower costs and declining capital investment per subscriber.[169] The CPUC states that its study of rates for the 1989-1993 period determined that the average, nominal rate (before inflation adjustment) for the basic plan remained unchanged in three markets, including the State's largest, increased in one market, and decreased by 5 percent or less in the other four markets studied. It also found that the basic retail rates were "nearly identical" in Los Angeles and Santa Barbara, and varied by less than 7 percent in all other markets except Sacramento.[170] When inflation is considered, California states, rates for basic plans in all markets have declined by an average of 14.9 percent, compared to the nominal reduction of 0.8 percent,[171] while operating expenses per subscriber have fallen by 47 percent in real terms and capital investment per subscriber has also declined substantially.[172]

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[165] *See, e.g.*, Comments of AirTouch at 60-61; GTE at 27 n.16, n.17.

[166] *See, e.g.*, Comments of McCaw, Owen Affidavit at 31-32.

[167] *See, e.g.*, GTE Comments, Appendix A at 8; AirTouch Comments at 59; CPUC Reply at 74-77.

[168] CPUC Petition at 45-46, citing, in support, U.S. General Accounting Office, "Telecommunications Cellular Service Competition," Testimony before the Senate Committee on Energy and Public Utilities, Legislature of the State of California, Jan. 12, 1993, at 7.

[169] CPUC Petition at 40-42.

[170] *Id.* at 34-35.

[171] Neither California's Petition nor Appendix I specifies the inflation adjustor applied to cellular carriers' rates.

[172] California cites a CTIA exhibit in its state proceeding that showed capital investment per cellular subscriber had declined from $1,816 to $978 between June 1988 and June 1993. CPUC Petition at 35 n.15.

71. California's 1989-1993 study examined pricing data from all plans offered by facilities-based carriers in the top five California Metropolitan Service Areas (MSAs) and two small Rural Service Areas (RSAs). California recognizes that carriers offer a variety of retail plans with different combinations of charges, terms and conditions, and states that the prevalence of discount plans makes comparing cellular prices over time difficult. The CPUC also states that a direct comparison of rates between discount plans and basic plans is "not valid, because discount plans have a number of restrictions and conditions which reduce their value." These include, according to the CPUC, the customer's loss of contractual flexibility, exposure to termination charges, and the possible denial of immediate access to new technologies as they become available.[173] California recognizes that, while most customers subscribed to the basic or "unrestricted" plan in the first years of cellular service, by 1993 only 37 percent of subscribers in major markets still were on that plan.[174]

72. California states that nominal rates for basic plans for both carriers in three of the markets studied have not changed in five years and asserts that national price trends for cellular service do not track declining costs.[175] The CPUC notes that, although it established rate guideline procedures in April 1993 that permit carriers who lower rates to restore them to previous levels on one day's notice, no single significant rate reduction has lasted more than three months in any market.[176] The CPUC invokes an analysis proffered by a party in its ongoing investigation, Cellular Services, Inc., purporting to show that most price reductions asserted by carriers either failed to reduce rates or expired.[177] The CPUC concedes that discount plans offer "modest rate relief to some customers," but insists that these reductions be considered "in terms of reduced flexibility, risk of termination fees and foregone access to emerging technologies."[178] To consider the effect of discount plans on rates, California contends, its study would have to be based on a random sample of customer bills and consider as well the costs of any restrictions or benefits outside the direct rates, *e.g.*, term contracts and discounts on customer premises equipment (CPE).

73. The cellular carriers' initial comments on pricing were made without the benefit of access to the confidential pricing data submitted by the CPUC with its Petition

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[173] *Id.* at 36-37.

[174] *Id.* at 40-41.

[175] *Id.* at 39, *citing* May 5, 1994, Wall Street Journal, "Cellular Phone Rates Spark Static From Users."

[176] CPUC Petition at 39 n.21.

[177] CPI's analysis asserts that by March 1994, only two of fifteen filings made in the year following adoption of the 1993 rate band guidelines remained in effect, and that of 34 price-reducing tariffs referenced by L.A. Cellular, only five actually reduced rates. *Id.* at 40.

[178] *Id.* at 43.

and, in consequence, are of correspondingly lesser importance than their supplemental comments and replies filed after their examination of these materials under the terms of the Protective Order.[179]

74. The carriers raise several issues in their supplemental comments and replies concerning the pricing arguments proffered by the CPUC. Several commenters emphasize, in the first instance, the CPUC's acknowledgment that cellular rates have declined over the past several years.[180] AirTouch asserts that, from 1990 to 1993, its prices in Los Angeles decreased almost five times more than costs decreased -- by a nominal 12.0 percent (a real 20 percent), while expenses dropped only 2.5 percent. It concedes that its analysis is based on rates for 200 minutes of use (MOU) but alleges that customers with lower usages also benefitted; *e.g.*, 10 MOU nominal prices decreased by 8.0 percent (a real 16.3 percent).[181] L.A. Cellular states that the rate data contained in Appendices I and J to the CPUC Petition are inaccurate, citing, in support, discrepancies between reported best rates for its own subscribers and those actually tariffed.[182]

75. Several carriers allege that, to the extent that high prices have existed, they are attributable, in some measure, to regulatory practices employed by the CPUC. Specifically, AirTouch asserts that its own usage prices did not decline between 1986 and 1990 because during that period rate reductions required 40 days' notice and the restoration of prices could entail a ''complete rate application'' hearing lasting as long as two years.[183] L.A. Cellular contends that price initiatives have taken the form of promotions because of ''regulatory inhibitions'' that persist. It states that ''new rate plans'' still require significant advance notice and that CPUC procedures require characterization of rate reductions as ''promotional'' if they are to be implemented with minimal delay.[184] It contends that complaints that these plans are not permanent in nature and that a basic rate reduction is

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[179] *See* discussion of Confidentiality in Section IV, *supra*.

[180] *See, e.g.*, CCAC Supplemental Reply Comments at 6-7.

[181] AirTouch Supplemental Comments at 8; Hausman Affidavit at para. 3.

[182] L.A. Cellular Supplemental Comments at 5.

[183] Hausman Affidavit at para. 4 n.2. Hausman contends that regulation by the CPUC is costing California cellular subscribers $240 million per year in higher cellular prices. L.A. Cellular also cites these regulatory requirements as impediments to cellular carriers' lowering rates. L.A. Cellular Supplemental Reply Comments at 7-8.

[184] L.A. Cellular Supplemental Comments at 12. See also its Supplemental Reply Comments alleging that alternative, discount plans have proliferated as a direct consequence of partial regulatory reforms introduced by the CPUC beginning in 1990, such as temporary tariffs and rate decreases on shorter notice. L.A. Cellular Supplemental Reply at 7-8.

preferable also ignore market mechanisms and the need to appeal to specific customer groups.

76. Other commenters take issue with the CPUC's use of rates for basic plans, rather than discount plans, to support its contentions with respect to the pricing of cellular service.[185] For example, based on its review of the confidential data concerning the percent of subscribers in the Los Angeles, San Diego and San Francisco markets that have remained on basic plans, AirTouch states that the vast majority of subscribers in the major California MSAs use discount plans providing greater savings, that the migration to discount plans accelerated in 1994 when AirTouch filed 16 new service plans during pendency of the CPUC Petition, and that the CPUC thus improperly relied on basic rate plans to assert that cellular prices are "stagnant or slowly declining."[186]

77. In addition, AirTouch states that the CPUC's comparison of prices to income per subscriber is flawed. It contends that, while plant investment per subscriber and operating expenses remained roughly constant from 1990 to 1993 (varying under 7 percent), income per subscriber decreased 47 percent. AirTouch attributes this decline to discount plans offering savings to subscribers that the CPUC has chosen to ignore and to lower usage by more recent subscribers.[187] It observes that, unlike AT&T's behavior when tariffing long distance service options, cellular carriers have not raised the price of basic plans when offering greater discount plans.[188]

78. In response to these comments, the CPUC states in its Supplemental Reply that price declines for cellular service do not determine whether current price levels are just and reasonable or whether the cellular industry is competitive and that a customer's choice between rate plans, none of which contains reasonable prices, terms and conditions, says nothing about the reasonableness of the discount plan selected.[189] The CPUC notes that some carriers concede that a comparison limited to discount rates, without consideration of other terms, may overstate the extent of savings, and contends that high growth rates or customer

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[185] *See, e.g.*, Charles River Associates for CCAC at 13; Supplemental Comments of AirTouch at 6-7; CCAC at 6-9; Supplemental Reply Comments of CCAC at 2-4; L.A. Cellular at 3-4.

[186] AirTouch Supplemental Comments at 6-7. *See* also CCAC Supplemental Comments at 6-7.

[187] AirTouch Supplemental Comments at 9.

[188] Hausman Affidavit at para. 6 n.3. Hausman also asserts that the declining profit per subscriber demonstrates the effect of competition. *Id.* at 3-4. He states that "[t]he decreased margins demonstrate an effective increase in competition of approximately 50% during this time period using the best known model of the markup of price over marginal cost with imperfect competition and large fixed costs found in the economic literature." *Id.* at 4 n.6.

[189] CPUC Supplemental Reply at 26-27.

migration between plans does not indicate the competitiveness of services or the reasonableness of prices.[190]

79. California asserts that the decline in operating income per customer noted by AirTouch is irrelevant to cellular firms' financial performance but does demonstrate that cellular carriers have found that serving comparatively few customers is advantageous. The CPUC adds that AirTouch's explanation that high cellular rates in New York and Los Angeles are attributable to capacity constraints contradicts its claim that regulation had caused higher prices in those markets.[191] The CPUC states that the cost of providing cellular service is declining faster than prices and that AirTouch has confused expenses with costs, using operating expenses per customer to show the competitiveness of cellular prices when the relation of cost to price is the proper focus.[192] The CPUC concedes that its annual reports do not adequately allocate between wholesale and retail operations and that a more accurate view of relevant expenses for providing cellular services would come from wholesale operations, but asserts the industry's prices are so unrelated to costs that "any convergence between revenue and expenses is meaningless."[193]

80. The CPUC states that the Hausman price study provided by AirTouch in its second-round comments demonstrates that state regulation has not dampened pricing flexibility, and confirms the difficulty of using published rates to analyze price changes. California argues the rate decreases shown by the AirTouch study are similar to those in unregulated markets, at the same time raising varied methodological issues about the study. The CPUC specifically challenges AirTouch's argument that capacity constraints explain high Los Angeles rates, as unsupported and inconsistent with the argument that regulation has occasioned higher rates there and in New York.[194] The CPUC asserts that the Hausman study also disregards conflicting data, ignores standard econometric techniques for establishing causality, and misuses the economic control variables it does consider, so that no relation between state regulation and rates, much less causality, is demonstrated.[195]

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[190] *Id.* at 25-26. The Cellular Resellers state that in the 1989-1993 period basic rates changed negligibly while number of customers increased substantially. *See* Cellular Resellers Supplemental Comments at 2-3.

[191] CPUC Supplemental Reply at 32.

[192] *Id.* at 28-29.

[193] *Id.* at 29-30.

[194] *Id.* at 31-32.

[195] *Id.* at 32-33.

c. Capacity Utilization

81. The CPUC and its supporters contend that cellular carriers' capacity is not being fully utilized and that this fact, rather than spectrum scarcity, accounts for the excessive rates and profits characteristic of cellular service.[196] The CPUC points out that the capacity for carriers in the Los Angeles and San Francisco MSAs, in particular, is significantly underutilized.

82. The cellular carriers argue that the dramatic growth rates for cellular systems in California, demonstrated by the CPUC's own subscriber growth data, contradict the CPUC's contention that carriers are intentionally restricting capacity.[197] Several commenters also point out that excess capacity is consistent with efficient network planning because cellular service does not experience economies of scale, so that additions to capacity are best made in "lumpy" investments.[198]

83. The cellular carriers also assert that the CPUC has ignored the effects of uneven usage attributable to variations in population density within a market and commuting patterns for which cellular systems must be able to accommodate demand during the busiest hours.[199] AirTouch notes that 19 percent of subscriber usage in Los Angeles is concentrated in less than one percent of that area served and asserts that the overall increase in demand sought by the CPUC would not increase usage of less heavily used sites or spare already-congested ones.[200] The carriers emphasize their "legitimate" concerns for high quality transmission and call-completion ratios and point out that the potential for blockage and service degradation increases when cell cites are used in excess of full capacity.[201]

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[196] CPUC Petition at 51-54. *See also, e.g.*, Comments of Utility Consumers' Action Network and Towards Utility Rate Normalization (UCANTURN) at 1-2; Supplemental Comments of the Cellular Resellers at 4.

[197] *See, e.g.*, Comments of Bakersfield at 10; BACTC at 34; GTE at 20; Supplemental Comments of AirTouch at 16-17; L.A. Cellular at 39. AirTouch, in particular, contends that, from 1984 to 1994, the Los Angeles system increased customers dramatically, increased cell sites from 13 to 415, and expanded capital investment from $10 million to $550 million. AirTouch Supplemental Comments at 17-18.

[198] Comments of CCAC, Appendix A at 28; Supplemental Comments of CCAC at 15-17; AirTouch at 17.

[199] *See, e.g.*, Supplemental Comments of L.A. Cellular at 8-9; CCAC at 15-17; Supplemental Reply of GTE at 3-4.

[200] AirTouch Supplemental Comments at 16-17.

[201] *Id.* at 14-15.

d. Rates of Return

84. As the gravamen of its argument, California alleges that cellular carriers in the State are earning excessive rates of return.[202] The CPUC defines excessive returns as "profits due solely to a failure to compete in a duopolistic market," and states that evidence of improper pricing would be pricing so high that it discourages use of the system, or failure to invest in system expansion when it is economically justified.[203] The CPUC believes that rates of return, when considered together with other factors, are relevant indicators of the market power of cellular carriers.[204]

85. California asserts that the six cellular carriers in the three major urban markets earned returns during the period 1988 to 1993 averaging 30.9 percent.[205] For example, California states that L.A. Cellular earned an average after-tax accounting rate of return of 56.2 percent for the last five years, while the Los Angeles MSA earned 37.9 percent.[206] Similarly, California states that BACTC's rates of return ranged from 31.1 percent in 1992 to 49.5 percent in 1993.[207] It finds no evidence that the risk faced by cellular carriers justifies returns as high as those in the major metropolitan areas.[208] California attributes the existence of high profit margins to the lack of perfect substitutes for cellular service and the exclusion of potential market entrants due to the dual license structure.[209]

86. The CPUC's analysis is based on after-tax accounting rates of return on net plant derived from carrier-provided unaudited annual reports to the CPUC.[210] The CPUC and its supporters argue that, as in the case of this Commission's cable and telephone rules,

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[202] *Id.* at 46-51.

[203] CPUC Petition at 50-51.

[204] *Id.* at 47.

[205] CPUC Supplemental Reply at 17.

[206] CPUC Petition at 48-49 & Appendix F.

[207] *Id.*

[208] *Id.* at 48; CPUC Supplemental Reply at 17 n.34.

[209] CPUC Petition at 50.

[210] *Id.* at App. F.

the rate base should not include the value of spectrum because carriers do not own the airwaves and including their value in the rate base "masks the duopoly profits."[211]

87. The cellular carriers disagree with the CPUC's analysis of the rate of return data. They argue that higher rates of return are appropriate because cellular is riskier than other telecommunication services[212] and that growth is an important factor in assessing market conditions and rates of return.[213] They also argue that operating profits are not excessive when they are used to increase service availability and enhance capacity, and GTE states that it has invested substantial sums for these purposes.[214] L.A. Cellular notes that, in an earlier decision, the CPUC found that cellular rates and rates of return were neither unreasonable nor excessive.[215] They also disagree with the CPUC's methodology for computing rates of return.

88. Specifically, the cellular carriers assert that California has erred by using an "accounting" as opposed to an "economic" rate of return; *i.e.*, by failing to consider return over the entire life of the system.[216] AirTouch contends that accounting rates of return are often a poor guide to true economic rates of return, which must take account of decreasing equipment prices, rapidly depreciating network infrastructure (resulting from conversion to digital), the inherent problems in valuating spectrum, and the replacement cost of acquiring new customers.[217] BACTC agrees, asserting that the CPUC should not use an accounting analysis because it is static and unable to assess future changes or results, including new competition and opportunity costs.[218]

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[211] CPUC Petition at 56-61. The CPUC adds that "[t]he difficulty in quantifying spectrum value is one of the reasons the CPUC has declined to adopt a cost-of-service regulatory structure for the cellular industry." *Id.* at 57.

[212] *See* Comments of AirTouch, Hausman Affidavit at 17, in which he advocates use of the capital asset pricing model and a 20.7 percent benchmark as a fair rate of return.

[213] *See, e.g.*, Comments of Bakersfield at 11.

[214] GTE Comments at 20; L.A. Cellular Reply at 36-37 & Fig. 8.

[215] L.A. Cellular Reply at 6-7.

[216] *See, e.g.*, Comments of AirTouch at 55-56; BACTC at 26; CCAC at 16 & Appendix A at 22; GTE at 19; McCaw at 43-44 (also asserting that start-up losses should have been capitalized and included in firms' rate bases).

[217] AirTouch Comments at 55-56.

[218] BACTC Comments at 26.

89. In response, California reiterates its argument that rates of return for cellular carriers are twice as high as those earned by the average firm in the telecommunications industry and notes that they are understated to the extent that investments have been financed with leveraged capital.[219] It points out that accounting returns are relied upon by Federal regulators and the investment community[220] and that the cellular carriers concede that an economic rate of return is difficult if not impossible to compute for an entire firm.[221]

90. In support, the Cellular Resellers argue that accounting rates of return represent return on investments actually made, whereas economic rates of return represent return on replacement or reproduction value of an entire system, including spectrum.[222] They argue that the carriers "would like to earn money on investments they have not made,"[223] but that this Commission, like other regulatory agencies, has for decades rejected such arguments on the grounds that investors are only entitled to a fair return on their actual investment and not a return on the reproduction or replacement value of the company's assets.[224]

91. The cellular carriers also criticize the CPUC for relying on rate of return figures for only the largest and most profitable markets.[225] AirTouch asserts that in Santa Barbara, the RSAs, San Diego, and San Francisco Block B, the rates of return are at or below competitive levels and that rates of return for the two cellular carriers in the Los Angeles market have decreased by 46 percent and 52 percent over the last five years and would decrease more if the CPUC would stop rate-regulating those markets.[226] CCAC adds

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[219] CPUC Reply at 37; Supplemental Reply at 18. California states that firms in Value Line's Telecommunications Services Industry group have, on average, a 13.9 percent rate of return.

[220] CPUC Reply at 36.

[221] *Id.* at 41.

[222] Cellular Resellers Reply at 39-45.

[223] *Id.* at 40.

[224] *Id.* at 41, citing, *inter alia*, Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 605-14 (1944); 1990 Rate Rep., 5 FCC Rcd 7507, 7521 (1990) (common carriers not entitled to a return on the "fair value" of their investment on the basis of the company's market value).

[225] GTE Comments at 19-20; *accord* L.A. Cellular Reply at 11, 28, 30-31.

[226] AirTouch Comments at 56-57; *see also* L.A. Cellular Supplemental Reply at 6.

that the wide differences in rates of return between large and medium or small markets are not indicative of market power since all markets are duopolies.[227]

92. In response, the CPUC asserts that the largest California markets represent most consumers of cellular services and that rates of return in these markets have ranged from 18.7 percent to 56.2 percent in the last five years, even though this was a period of severe economic recession in the State.[228] The Cellular Resellers agree with the relative weight to be placed on rate of return data in smaller as opposed to larger cellular markets and note that the carriers in the smaller markets serve only 15 percent of California's subscribers, have been in operation fewer years and serve markets with lower population densities.[229]

93. The cellular carriers also argue that California erred in disregarding the value of scarce spectrum in calculating rates of return, even where a system was obtained via a set-aside rather than purchase.[230] L.A. Cellular contends that "[w]hen account is taken of up-front acquisition costs, the profit levels cited by the CPUC must be reduced by at least 50%."[231] The carriers suggest several methodologies for valuating spectrum, including using the results of the narrowband PCS auction as a guide.[232]

94. In response, California points out that a majority of carriers acquired their spectrum for free[233] but adds that, in any event, there can be no opportunity cost for cellular spectrum because it has no alternative use under present guidelines established by this

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[227] CCAC Supplemental Comments at 12.

[228] CPUC Reply at 35.

[229] Cellular Resellers Supplemental Comments at 4 & Supplemental Reply at 7. *But see* Supplemental Reply of L.A. Cellular at 4-5, disputing allegation that major markets were given a "head start."

[230] *See* Comments of AirTouch at 59 & n.185, Exhibit E at 15 & n.18; L.A. Cellular at 25-27; CCAC at 29-52; CCAC Reply at 14. *See also* Comments of McCaw at 45, Owen Affidavit appended thereto at 22-24.

[231] L.A. Cellular Supplemental Reply at 6.

[232] L.A. Cellular Comments at 27. *But see* CPUC Supplemental Reply at 23, arguing that a comparison of the per POP spectrum value for narrowband or, more appropriately, broadband PCS based on auction results with that for cellular spectrum reveals cellular's present and continuing ability to extract economic rents reflective of the duopoly market structure.

[233] CPUC Supplemental Reply at 22.

Commission.[234] The CPUC argues that including spectrum value in the rate base would artificially reduce the apparent profit and that, following this approach, any entry barrier could be eliminated as the source of duopoly profits and simply turned into a "cost of doing business" through reclassification as a capitalized investment.[235] California notes that the carriers' capital accounts may already reflect at least some measure of the costs that cellular carriers have incurred in license acquisition,[236] and observes that L.A. Cellular, trying to avoid increased tax liability, admitted to the California Board of Equalization that spectrum holds no value and should not be factored into earnings.[237]

95. In support of the CPUC's position, L.A. County contends that, because cellular licenses are scarce, their market price is bid up well in excess of actual cost.[238] It contends that "only about one-tenth of the capitalized 'value' of a cellular franchise is attributable to investments in tangible system assets, the balance representing the premium ... either paid by a purchaser of a cellular franchise or imputed ... even where the license was acquired without any cost whatsoever ...."[239]

E. Discussion

96. In order for a state to prevail on the merits, Section 332(c)(3)(B) requires it to demonstrate that market conditions fail to protect subscribers adequately from unjust and unreasonable rates, or unjustly or unreasonably discriminatory rates. Based on a preponderance of the evidence, we conclude that California's demonstration does not satisfy the statutory standard. Therefore, we deny the CPUC's request to retain cellular rate regulation authority through March 1, 1996.

97. The principal bases for our decision are straightforward. First, unrebutted evidence shows that cellular rates in California are declining. Second, the CPUC Petition does not address the direct and fundamental changes to the duopoly cellular market structure that are being realized by PCS and other services, such as wide area SMR. Third, the CPUC presents no evidence of systematically collusive or other anticompetitive practices concerning the provision of any CMRS. Fourth, the CPUC does not present evidence showing

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[234] *Id.* at 21.

[235] CPUC Reply at 51-56, citing Hazlett, "Errors in the Haring & Jackson Analysis of Cellular Rates," attached as Appendix M, at 9. *See also* CPUC Supplemental Reply at 21-22.

[236] CPUC Reply at 48.

[237] *Id.* at 54-56.

[238] L.A. County Comments at 27-28, 39-42.

[239] *Id.* at 35.

widespread consumer dissatisfaction with CMRS providers in that state, or discuss what specific rate regulations are needed to address whatever level of dissatisfaction may exist.[240] Fifth, the CPUC fails to advance any persuasive analysis regarding the critical issue of investment by cellular licensees (or by any other CMRS providers). An important indicator of market failure, in our view, would be evidence that cellular firms are withholding investment in facilities as a means of restricting output and thus boosting price. No such demonstration exists on this record.

98. Another weakness of the CPUC's Petition is that it views any evidence of market imperfection as proof of a need for continued rate regulation, while all countervailing evidence is attributed to its regulatory oversight. Even assuming such an argument is reasonable in theory, the CPUC has not established its factual predicate. The CPUC does not appear to have prescribed any particular pricing or rate development formula, and with minor exceptions, all currently effective and previously effective cellular rates in California appear to have been carrier-initiated.[241] On this record, we are not persuaded by the CPUC's implicit argument that, absent continuation of its rate regulation authority, even for a limited period of time, cellular rates will quickly fall outside the zone of reasonableness.

99. We find the CPUC case, when viewed as a whole, to be unpersuasive. Examining each element of that case leads us to the same conclusion.

1. Structure

100. The CPUC's case consists in major part of a traditional antitrust analysis of the market for cellular services in California. The analysis includes empirical calculations of the market's level of concentration,[242] and is fleshed out by references to the conclusions

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[240] The CPUC concedes that consumers "rarely" file formal complaints against cellular carriers. CPUC Reply at 85. Although the CPUC asserts it receives "hundreds" of informal consumer complaints annually, it provides no other details about such complaints. *See id.*

[241] It is our understanding that the percentage difference between wholesale and retail rates in carriers' tariffs (*i.e.*, the so-called"reseller margin") was structured initially by carriers themselves, not the CPUC. There has never been a Federal requirement that carriers offer separate wholesale and retail rates. *See Cellular Resale Order*, 6 FCC Rcd 1719, 1726 (1991).

[242] The most widely used measure is the so-called Herfindahl-Hirschman Index, or HHI. *See* Scherer and Ross at 72. The HHI is calculated by squaring the market share of each market participant and then adding the squares, with the sum representing the degree of market concentration. In merger cases this calculation is made for both "pre-" and "post-merger" markets, the difference being the increase in market concentration that will result from the merger. The higher the pre-merger number, and the greater the increase to that number a merger will cause, the more likely the merger may violate the antitrust laws. *See* FTC v. PPG Industries, Inc., 798 F.2d 1500, 1503 (D.C. Cir. 1986); *see also* Scherer and Ross at 72. One portion of the CPUC's case appears to utilize a derivative of the HHI (*i.e.*, a Herfindahl Index), but the use of this alternative measure is without

of others who had examined the market prior to the CPUC's filing in August 1994 and found it to be less than fully competitive, including the U.S. Department of Justice.[243] California also highlights the existence of interlocking ownership interests among various carriers,[244] and argues that these relationships weaken competition. We do not dispute the analysis of past market conditions offered by the CPUC, nor doubt the existence of the ownership arrangements it cites. Indeed, as noted previously, the CPUC could have presented even more analysis of this nature, including various examinations of the cellular market structure by this Commission and the General Accounting Office.

101. Several observations about these materials are in order, however. First, although the market analyses offered by California are conducted from the perspective of the antitrust laws, the CPUC disclaims the argument that antitrust standards are the appropriate measure of market conditions in a proceeding under Section 332(c)(3)(A). Taking that disclaimer at face value, it is not obvious why antitrust-oriented analyses should be accorded decisional weight in this proceeding. Moreover, as noted previously, Congress was well aware of the historical condition of the market for cellular service in 1993 when it broadly prohibited state rate regulation of CMRS. It easily could have made traditional antitrust considerations the yardsticks for evaluating state petitions, but it did not. To the contrary, the record indicates that Congress affirmatively declined to adopt this approach.[245] California has not explained how a standard apparently rejected by Congress could thereafter become the centerpiece of the test for evaluating state petitions.

102. Second, although the CPUC claims that interlocking ownership interests weaken competition among the cellular carriers involved, its case on this point is entirely theoretical. The CPUC offers no direct or indirect proof that such arrangements actually are having *any* impact on competition. Moreover, the mere existence of such arrangements demonstrates little because this ownership pattern is partly a consequence of our initial cellular licensing procedures, which encouraged settlements and thus led to the creation of

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analytical or decisional significance because the two indices are essentially the same.

[243] On July 25, 1994, the U.S. Department of Justice filed a Memorandum in Response to the Bell Companies' Motions for Generic Wireless Waivers with the United States District Court for the District of Columbia Circuit, Civil Action No. 82-0192 (DOJ Memorandum). In that document, DOJ states that the "cellular exchange service markets are not competitive today." *Id.* at 13-14. The DOJ Memorandum is referenced at various points in the filing of the CPUC and its supporters. *See, e.g.,* CPUC Comments at 27.

[244] Petition at 27-28, Appendix C.

[245] Legislative history materials submitted by the Cellular Resellers suggest that amendments designed to make antitrust standards the test of Section 332(c)(3)(A) petitions were offered in committee and explicitly rejected.

partnerships in certain instances.[246] Thus, we accord little weight to the CPUC's claims on this point.

103. Third, the CPUC's analysis does not fairly reflect the speed at which CMRS market structure conditions affecting cellular services are evolving. To some degree this may be attributed to the fact that the CPUC's petition dates back to August 1994 and, as witnessed by the substantial presentation the state makes, required several months' preparation before then. During the intervening period we, *inter alia:* (1) completed our proceeding to establish broadband PCS services, pursuant to which we will license six new CMRS competitors to existing cellular providers; (2) utilized our pioneer preference procedures to award a 30 MHz broadband PCS license in the Los Angeles MTA; and (3) concluded an auction of the remaining 30 MHz MTA broadband PCS licenses throughout California (and the Nation). During this period an additional two-way mobile voice and data service provider, Nextel, also has significantly developed as a competitive alternative to cellular services.[247] The CPUC was not in a position to factor these developments into its own estimate that competitive market conditions will be sufficiently developed to warrant elimination of state rate regulation authority by March 1, 1996. The more relevant observation, however, is that their occurrence provides a reasonable basis to conclude that the CPUC's estimated timetable should be shortened.

104. Our own view is that an influx of additional competitors is a far superior solution to perceived cellular market inadequacies than continued rate regulation. More importantly, Congress embedded in the OBRA this preference for permitting market forces to develop rather than to rate regulate existing licensees, and that informs our judgment of petitions under Section 332(c)(3)(A). On this record, we conclude the CPUC has failed to demonstrate that the structure of the market for cellular service provides a basis for continuing state rate regulation authority.

2. Conduct

105. The "conduct" component of SCP analysis may be thought of as an examination of a market to identify any specific acts by participants that illustrate imperfect market conditions. The CPUC presents two examples in this regard. First, it claims that cellular carriers tacitly collude to price their services in parallel. Second, it asserts that

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[246] *See* Amendment of the Commission's Rules To Establish New Personal Communications Services, 9 FCC Rcd 4957, 5002 (1994).

[247] Although the record contains various expressions of doubt concerning Nextel's ability to mount viable competition to cellular operators, the company recently appears to have secured over $1 billion in financial backing from investors with long experience and success in mobile telecommunications operations. *See Business Week*, Apr. 17, 1995, "McCaw Is Getting A Lot More Than A Chunk Of Nextel."

carriers are using long-term service contracts in ways that demonstrate market conditions warrant continued state rate regulation.[248]

106. The CPUC's case on these points is flawed in several significant respects. To begin with, parallel pricing is consistent with a variety of economic models of industrial organization,[249] and some of these models include situations in which the subject prices are reasonable (such as perfect competition). Absent evidence of actual pricing collusion or a related indication of market failure -- and the CPUC has provided none -- the existence of pricing similarities does not automatically demonstrate unreasonable market conditions. We are particularly constrained from according significant weight to this aspect of the CPUC's case in view of its tariffing requirement, a regulatory device that tends to facilitate pricing commonality.

107. We also are unpersuaded by the CPUC's presentation regarding carriers' uses of long-term service contracts. The CPUC's problem is not with such contracts *per se*, as it continues to permit their use. Rather, California contends that "automatic renewal" provisions within such contracts, and evidence obtained by the California Attorney General's Office suggesting that certain carriers may be attempting to utilize such contracts to thwart PCS entry, demonstrate that market conditions are unjust and unreasonable.

108. Even if we take as given the CPUC's determination that certain automatic renewal provisions are unreasonable, it does not follow that the existence of such provisions demonstrates market failure under Section 332(c)(3)(A). Unreasonable business practices can and do arise in competitive markets. Without more, such practices are not necessarily suggestive, much less conclusive, with respect to market conditions. This portion of the CPUC's case simply fails to establish a sufficient nexus between the narrow practice complained of and the relevant, and much broader, statutory test.

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[248] CATA presents a third "conduct" example. Specifically, CATA asserts that cellular carriers increasingly distribute services through their own sales forces and "major mass merchandisers," rather than through independent agents, in an attempt to monopolize the cellular equipment market. This assertion is all sail and no rudder, as CATA supplies no evidence to buttress its claim. We previously have rejected bare allegations that the impact on resellers of cellular carriers' choice of product distribution systems constitutes adequate evidence of an attempt to monopolize the markets in which cellular service and equipment are provided. *See* Bundling of Cellular Customer Premises Equipment and Cellular Service, 7 FCC Rcd at 4028, 4031-32 (1992). CATA provides no basis to revisit those issues here.

[249] *See* Scherer and Ross at 200-15. Predictions of similar prices can arise in two ways. First, if two firms produce products that are similar, a firm charging substantially more would lose most of its customers. Second, if cost and demand are similar, then mathematical calculations of the companies' optimal pricing strategies tend to be similar.

109. These considerations alone are sufficient to discount these practices as insufficiently material to the statutory standard to warrant according them significant weight. We also note, however, that we are not prepared on this record to determine whether state oversight of such practices is precluded under the terms of OBRA as "rate regulation," or whether such oversight may be retained by the states as "terms and conditions" regulation. *See* Section VI, *infra,* Regulation of Other Terms and Conditions.

110. The more troublesome CPUC allegation concerns the use of long-term contracts to "lock down" cellular carriers' customer bases and thereby prevent or delay subscribers from taking advantage of competitive PCS alternatives. We view this allegation seriously because such conduct, if true, strikes at the heart of Congress's plan to build a robustly competitive mobile telecommunications marketplace by significantly increasing the spectrum available for such services. We accord more weight to this CPUC allegation than its parallel pricing contentions because the former is buttressed by evidence drawn from the record of an on-going investigation by the California Attorney General's Office. In the context of the instant proceeding, however, the key term here is "on-going." To our knowledge, neither the Attorney General nor the CPUC has acquired sufficient evidence to support even the initiation of formal action against the carriers to whom the "lock-down" evidence relates. Since the existing evidence apparently is inadequate to support CPUC action under its existing authority, we conclude that such evidence does not constitute an adequate brief for continuing such authority.[250]

3. Indicia of Performance

111. The "indicia of performance" component of SCP analysis may be thought of as an examination of empirical evidence of market behavior. We perform such an examination here to determine whether the CPUC has satisfied the statutory requirement of demonstrating that "market conditions ... fail to protect subscribers adequately from unjust and unreasonable rates or rates that are unjustly or unreasonably discriminatory." As discussed previously, we view this as a question whether market operations fail to produce rates that fall within a "zone of reasonableness," which is defined by reference to consumer interests, investor interests, and broad-based public policy considerations. Such an inquiry focuses foremost on cellular prices and profits.

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[250] We note that our denial of the CPUC's petition to retain its rate regulation authority does not prevent that agency, or the California Attorney General, from continuing to monitor the business practices of CMRS providers in that state. If such oversight yields more conclusive evidence that cellular carriers are attempting to forestall competitive PCS entry, or are engaging in other specific anticompetitive activities, we would entertain a CPUC petition to initiate targeted rate regulation measures designed to address such carrier actions, and would consider initiating such measures under our own authority, even absent a filing by the CPUC.